

**KARSCH CAPITAL, LTD.**  
**(a Cayman Islands company)**

**FINANCIAL STATEMENTS**

**JUNE 30, 2006**

# KARSCH CAPITAL, LTD.

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**June 30, 2006**

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# GOLDSTEIN GOLUB KESSLER INTERNATIONAL CAYMAN

Accountants and Consultants

## INDEPENDENT AUDITOR'S REPORT

To the Shareholders and Directors of  
Karsch Capital, Ltd.

We have audited the accompanying statement of assets and liabilities of Karsch Capital, Ltd. (the "Fund"), including the condensed schedule of investments, as of June 30, 2006, and the related statements of income, changes in net assets, and cash flows for the year then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Karsch Capital, Ltd. as of June 30, 2006, and the results of its operations, the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

*Goldstein Golub Kessler International Cayman*

**GOLDSTEIN GOLUB KESSLER INTERNATIONAL CAYMAN**

October 12, 2006

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**KARSCH CAPITAL, LTD.****STATEMENT OF ASSETS AND LIABILITIES**

(expressed in U.S. dollars)

**June 30, 2006****Assets:**

Investments in securities, at fair value (cost \$729,830,550)	\$ 804,275,706
Due from brokers	559,518,470
Interest and dividends receivable	1,525,009
Other assets	45,225

<b>Total Assets</b>	<b>1,365,364,410</b>
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**Liabilities:**

Securities sold short, at fair value (proceeds \$305,024,101)	296,717,871
Deferred fees payable	59,180,163
Performance fee payable	10,260,179
Shareholder equalization payable	5,090,959
Shareholder redemptions payable	34,109,522
Interest and dividends payable	339,249
Accrued expenses	317,274

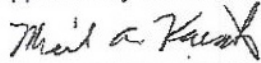
<b>Total Liabilities</b>	<b>406,015,217</b>
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<b>Net Assets</b>	<b>\$ 959,349,193</b>
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**Net Asset Value per Share:**

Class A - based on net assets of \$356,727,264 and 2,133,320.73 shares outstanding	\$ 167.22
Class B - based on net assets of \$600,745,380 and 3,862,896.65 shares outstanding	\$ 155.52
Class C - based on net assets of \$1,876,549 and 9,500.97 shares outstanding	\$ 197.51

Approved by the Board:



Director

The accompanying notes form an  
integral part of the financial statements

# KARSCH CAPITAL, LTD.

## CONDENSED SCHEDULE OF INVESTMENTS

(expressed in U.S. dollars)

June 30, 2006

Number of Shares	Description		Fair Value
	France		
	Banks	.11%	\$ 1,093,254
769,870	Engineering and Constructions		
	Vinci SA	8.26%	79,277,456
	Real Estate Investment Trusts	.50%	4,837,834
	<b>Total France common stocks (cost \$76,092,335)</b>	8.87%	85,208,544
	Germany		
642,819	Diversified Financial Services		
	Deutsche Boerse AG	9.14%	87,683,906
	<b>Total Germany common stocks (cost \$80,874,305)</b>	9.14%	87,683,906
	Netherlands		
	Investment Companies	2.72%	26,110,093
	Real Estate Investment Trusts	.24%	2,313,431
	<b>Total Netherlands common stocks (cost \$23,821,133)</b>	2.96%	28,423,524
	Switzerland		
	Diversified Financial Services	2.22%	21,262,547
	<b>Total Switzerland common stocks (cost \$22,698,543)</b>	2.22%	21,262,547
	United Kingdom		
	Real Estate Investment Trusts	1.61%	15,401,573
	<b>Total United Kingdom common stocks (cost \$14,000,453)</b>	1.61%	15,401,573
	<b>Total foreign common stocks (cost \$244,393,943)</b>	27.50%	263,830,747
	<b>Total common stocks (cost \$722,042,015)</b>	83.51%	801,115,418
	Corporate Bonds - United States		
	Media	.04%	404,250
	<b>Total United States bonds (cost \$663,338)</b>	.04%	404,250

Percentages shown represent percent of net assets.

(continued)

The accompanying notes form an  
integral part of the financial statements



# KARSCH CAPITAL, LTD.

## CONDENSED SCHEDULE OF INVESTMENTS

(expressed in U.S. dollars)

June 30, 2006

Number of Shares	Description		Fair Value
Put and Call Options Purchased - United States			
	Agriculture	.01%	\$ 118,295
	Auto Manufacturing	.04%	417,560
	Diversified Financial Services	.00%	5,513
	Healthcare Services	.16%	1,523,148
	Investments	.02%	228,915
	Media	.03%	301,410
	Retail	.02%	161,197
<b>Total put and call options purchased - United States (cost \$7,125,197)</b>			
		.28%	2,756,038
<b>Total investments in securities (cost \$729,830,550)</b>			
		83.83%	\$804,275,706
Common Stocks Sold Short - United States			
	Advertising	1.27%	\$ 12,182,488
	Agriculture	.00%	8,812
	Auto Manufacturers	3.67%	35,205,270
	Banks	.38%	3,674,625
	Diversified Financial Services	1.30%	12,457,197
	Entertainment	.37%	3,589,719
	Food	1.09%	10,461,504
	Forest Products and Paper	1.34%	12,836,028
	Investments	5.64%	54,066,080
	Leisure Time	.14%	1,388,717
	Machinery	.96%	9,181,494
	Manufacturers	.54%	5,222,680
	Oil and Gas	.35%	3,356,422
	Retail	4.90%	47,039,748
	Semiconductors	1.05%	10,104,744
	Software	.58%	5,555,040
	Telecommunications	.20%	1,966,640
<b>Total United States common stocks sold short (proceeds \$236,654,610)</b>			
		23.78%	228,297,208

Percentages shown represent percent of net assets.

(continued)

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integral part of the financial statements

# KARSCH CAPITAL, LTD.

## CONDENSED SCHEDULE OF INVESTMENTS

(expressed in U.S. dollars)

June 30, 2006

Number of Shares	Description		Fair Value
	Common Stocks Sold Short - Foreign		
	Canada		
	Pharmaceuticals	1.83%	\$ 17,571,255
	<b>Total Canada common stocks (proceeds \$18,301,856)</b>	1.83%	17,571,255
	Denmark		
	Electrical Components and Equipment	.63%	6,052,700
	<b>Total Denmark common stocks (proceeds \$5,412,058)</b>	.63%	6,052,700
	France		
	Diversified Financial Services	1.71%	16,381,809
	<b>Total France common stocks (proceeds \$15,572,697)</b>	1.71%	16,381,809
	Germany		
	Real Estate	.37%	3,564,453
	<b>Total Germany common stocks (proceeds \$3,662,052)</b>	.37%	3,564,453
	Italy		
	Commercial Services	1.67%	15,989,587
	<b>Total Italy common stocks (proceeds \$16,773,830)</b>	1.67%	15,989,587
	Spain		
	Real Estate	.88%	8,461,955
	<b>Total Spain common stocks (proceeds \$8,018,858)</b>	.88%	8,461,955
	<b>Total foreign common stocks sold short (proceeds \$67,741,351)</b>	7.09%	68,021,759

Percentages shown represent percent of net assets.

(continued)

The accompanying notes form an  
integral part of the financial statements

**KARSCH CAPITAL, LTD.****CONDENSED SCHEDULE OF INVESTMENTS**

(expressed in U.S. dollars)

**June 30, 2006**

<b>Number of Shares</b>	<b>Description</b>	<b>Fair Value</b>
Corporate Bonds Sold Short - United States		
Media	.04%	\$ 398,904
<b>Total United States bonds sold short (proceeds \$628,140)</b>		.04% 398,904
<b>Total securities sold short (proceeds \$305,024,101)</b>		30.91% \$296,717,871
Currency Forwards <sup>(a)</sup>		\$ (5,374,723)
Equity Swaps <sup>(a)</sup>		\$ (4,912,514)
Index Future Swaps <sup>(a)</sup>		\$ (2,977,614)

(a) The fair value of the currency forwards, equity swaps and index future swaps as indicated above is included in due from brokers on the accompanying statement of assets and liabilities.

Percentages shown represent percent of net assets.

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integral part of the financial statements



**KARSCH CAPITAL, LTD.****STATEMENT OF INCOME**

(expressed in U.S. dollars)

**Year ended June 30, 2006**

Investment income (loss):	
Interest	\$ 20,699,322
Dividends (net of withholding taxes)	21,787,066
Total income	42,486,388
Expenses:	
Performance fee	29,573,657
Management fee	14,646,842
Dividends	10,148,205
Interest and other expenses	6,447,135
Net investment gain on deferred fees	6,033,505
Professional fees	697,092
Total expenses	67,546,436
Net investment loss	(25,060,048)
Realized and unrealized gain (loss) on investments:	
Net realized gain on investments	162,111,993
Net change in unrealized depreciation of investments	(7,652,438)
Net realized and unrealized gain on investments	154,459,555
Net income	\$129,399,507

The accompanying notes form an  
integral part of the financial statements

## KARSCH CAPITAL, LTD.

### STATEMENT OF CHANGES IN NET ASSETS

(expressed in U.S. dollars)

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#### Year ended June 30, 2006

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Increase (decrease) in net assets resulting from operations:	
Net investment loss	\$ (25,060,048)
Net realized gain on investments	162,111,993
Net change in unrealized depreciation of investments	(7,652,438)
Net increase in net assets resulting from operations	129,399,507
Increase in net assets resulting from capital transactions - issuance of shares*	292,614,910
Decrease in net assets resulting from capital transactions - redemption of shares*	(653,079,727)
Net assets at beginning of year	1,190,414,503
Net assets at end of year	\$ 959,349,193

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\* Includes net transfers from Class B to Class A of \$83,051,023.

The accompanying notes form an  
integral part of the financial statements

**KARSCH CAPITAL, LTD.****STATEMENT OF CASH FLOWS**

(expressed in U.S. dollars)

**Year ended June 30, 2006****Cash flows from operating activities:**

Net increase in net assets resulting from operations	\$ 129,399,507
Adjustments to reconcile net increase in net assets resulting from operations to net cash provided by operating activities:	
Changes in operating assets and liabilities:	
Decrease in due from brokers	156,686,024
Decrease in investments in securities, at fair value	11,479,255
Increase in interest and dividends receivable	(587,127)
Increase in other assets	(43,505)
Decrease in securities sold short, at fair value	(40,568,270)
Decrease in performance fee payable	(550,380)
Increase in deferred fees payable	25,875,477
Decrease in interest and dividends payable	(53,669)
Increase in accrued expenses	26,279

<b>Net cash provided by operating activities</b>	<b>281,663,591</b>
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**Cash flows from financing activities:**

Proceeds from capital subscriptions	212,247,717
Redemption of shares	(493,911,308)

<b>Net cash used in financing activities</b>	<b>(281,663,591)</b>
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Net change in cash and cash at end of year	\$ - 0 -
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**Supplemental disclosure of cash flow information:**

Cash paid during the year for interest	\$ 4,527,923
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**Supplemental schedule of noncash financing activities:**

Shareholder redemptions payable	\$ 34,109,522
Distributions of securities to shareholders (at fair value)	\$ 54,077,451
Issuance and redemption of shares transferred between classes	\$ 83,051,023

The accompanying notes form an integral part of the financial statements

## KARSCH CAPITAL, LTD.

### NOTES TO FINANCIAL STATEMENTS

(expressed in U.S. dollars)

June 30, 2006

#### 1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES:

Karsch Capital, Ltd. (the "Fund") was formed in September 2000 pursuant to the laws of the Cayman Islands to invest and trade in securities and commenced operations on October 2, 2000. The investment manager of the Fund is Karsch Capital Management, LP (the "Investment Manager").

These financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America which require the use of estimates by the Investment Manager. Actual results could differ from those estimates.

Investments in securities traded on a national securities exchange or listed on the Nasdaq National Market ("Nasdaq") are valued at the last reported sales price on the primary exchange on which such securities have traded on the last business day of the year. Investments in securities traded in the over-the-counter market and not listed on Nasdaq are valued at the last reported bid price if held long, or ask price if sold short. Options listed on a national securities exchange or Nasdaq will be valued at the mean between their bid and ask prices.

Purchases and sales of securities are recorded on a trade-date basis. Realized gains and losses are recognized based on the specific-identification method. Dividend income and dividends on securities sold short are recorded on the ex-dividend date.

Under the current laws of the Cayman Islands, the Fund is not subject to income taxes and, accordingly, no provision has been made in the accompanying financial statements for such taxes.

The industry classifications included in the condensed schedule of investments represent the Investment Manager's belief as to the most meaningful presentation of the classification of the Fund's investments.

Assets and liabilities denominated in foreign currencies are translated into U.S. dollar amounts at the year-end exchange rates. Purchases and sales of investments, and income and expenses, that are denominated in foreign currencies are translated into U.S. dollar amounts on the transaction date. Adjustments arising from foreign currency transactions are reflected in the statement of income.

#### 2. DUE FROM BROKERS/ SECURITIES HELD AT BROKER:

The clearing and depository operations for the Fund's security transactions are provided by three brokers, one of which, Goldman Sachs & Co., serves as the Fund's primary broker, in which capacity it is custodian of substantially all the Fund's security positions and cash. At June 30, 2006, substantially all of the securities owned and the amount due from brokers reflected in the statement of assets and liabilities are positions with and amounts due from this broker.

Investments in securities and securities sold short are subject to margin requirements.



## KARSCH CAPITAL, LTD.

### NOTES TO FINANCIAL STATEMENTS

(expressed in U.S. dollars)

June 30, 2006

**3. DERIVATIVE  
FINANCIAL  
INSTRUMENTS:**

The Fund's activities include the purchase and sale of a variety of derivative financial instruments such as equity options, forward currency contracts, equity swaps and index future swaps. These derivatives are used for trading purposes and for managing risk associated with the portfolio of investments. All positions are reported in the accompanying statement of assets and liabilities at either fair value or open-trade equity and any change in fair value is reflected in the accompanying statement of income as gain or loss as it occurs.

**4. SECURITIES  
SOLD SHORT:**

Subsequent market fluctuations may require the Fund to purchase these securities at prices that differ from the market value reflected in the statement of assets and liabilities.

**5. SHAREHOLDERS'  
EQUITY:**

The Fund's authorized capital is \$150,000 consisting of 15,000,000 common shares, each having a par value of \$0.01 per share. The common shares are divided into Class A common shares ("Class A shares"), Class B common shares ("Class B shares") and Class C common shares ("Class C shares"). Generally, Class A, B and C shares have equal voting, dividend, distribution and liquidation rights. Class A shares are offered to investors who are not restricted from participating in New Issue securities as defined in the Articles of Association. Class B shares are offered to investors who are restricted from participating in new issue securities. Class C shares may only be purchased by investors who are affiliates of the Investment Manager.

Changes in common shares for the year ended June 30, 2006 are as follows:

	Class A	Class B	Class C
Shares outstanding at beginning of year	1,969,886.98	6,530,641.51	9,500.97
Issued during the year	1,028,352.46	768,792.69	
Redeemed during the year	(864,918.71)	(3,436,537.55)	
Shares outstanding at end of year	2,133,320.73	3,862,896.65	9,500.97

Shares in the Fund may be purchased at net asset value on the first day of each calendar month or on such other days as the Investment Manager may determine. Shares may be redeemed on the last day of each calendar month at net asset value or on such other days as the board of directors may determine.



## KARSCH CAPITAL, LTD.

### NOTES TO FINANCIAL STATEMENTS

(expressed in U.S. dollars)

June 30, 2006

**6. INVESTMENT  
MANAGEMENT  
AND  
PERFORMANCE  
FEES:**

The Investment Manager provides investment advisory services to the Fund and in consideration receives a management fee in the amount of .375% per quarter (1.5% per annum). The fee is paid quarterly in advance and is based on the value of the net assets of the Fund as of the beginning of the quarter. The fee is adjusted for any additional subscriptions or redemptions made during the quarter. Management fee expense charged to operations amounted to \$14,646,842 for the year ended June 30, 2006.

The Investment Management Agreement (the "Agreement") provides for a fee paid to the Investment Manager of 20% of the net income that is allocable to each common share of Class A and Class B shares of the Fund.

Under the terms of the Agreement, the Investment Manager may elect to defer the payment of the management and performance fees. Any deferred fee is reinvested in the Fund to earn a rate of return as if such deferred amounts had been invested in the Fund as a shareholder. The Investment Manager has deferred \$2,985,557 of management fees and \$16,856,415 of performance fees earned for the year ended June 30, 2006. The election defers 75% of the management fee deferral through June 30, 2011 with the remaining balance deferred through June 30, 2016. The election defers 12.28% of the performance fee deferral through June 30, 2011 with the remaining balance deferred through June 30, 2016.

Effective April 1, 2006, the Fund redeemed shareholder interests of \$88,622,067 including securities having a fair value of \$54,077,451 to Karsch Capital II, Ltd., an affiliated fund.

**7. SHAREHOLDER  
EQUALIZATION  
PAYABLE:**

Shareholder equalization payable is an amount due to certain shareholders calculated on the subscription day as the amount equal to 20% of the difference, if positive, between the net asset value per common share on the immediately preceding valuation day and the net asset value per common share on the first day of the fiscal year in which the subscription day falls multiplied by the number of shares purchased.

**8. ADMINISTRATOR  
FEE:**

Under the terms of an administration agreement, Goldman Sachs (Cayman) Trust Limited, a Cayman Islands corporation, (the "Administrator") was appointed administrator to the Fund. Pursuant to the above agreement, the Administrator receives from the Fund remuneration for services rendered at the Administrator's standard rates for such services. These fees are reflected in professional fees in the statement of income.

**9. SUBSEQUENT  
EVENTS:**

Subsequent to June 30, 2006, share subscriptions and redemptions amounted to \$25,155,000 and \$71,164,727, respectively.

**KARSCH CAPITAL, LTD.****NOTES TO FINANCIAL STATEMENTS**

(expressed in U.S. dollars)

**June 30, 2006****10. FINANCIAL HIGHLIGHTS:**

The information presented below represents the financial highlights for the applicable shareholder class of the Fund taken as a whole.

Per Share Operating Performance (for a share of capital stock outstanding throughout the year):

	Class A	Class B	Class C
Net asset value at beginning of year	\$145.83	\$138.05	\$168.00
Net investment income (loss)	(3.90)	(4.59)	3.65
Net realized and unrealized gain	25.29	22.06	25.86
Net asset value at end of year	\$167.22	\$155.52	\$197.51
Total return before performance fee	18.29 %	15.82 %	17.56%
Performance fee	(3.62)	(3.17)	
Total return after performance fee	14.67 %	12.65 %	17.56%

Total return is calculated for a share of capital stock outstanding throughout the year. An individual investor's return may vary from these returns based on different management fee arrangements and the timing of subscriptions and redemptions.

Supplemental Data:

Ratio to average net assets:

	Class A	Class B	Class C
Operating expenses (including short dividends)	4.04 %	3.81 %	2.63%
Performance fee	2.81	3.39	
Total expenses	6.85 %	7.20 %	2.63%
Net investment income (loss)	(2.36)%	(2.98)%	2.09%

The ratios shown above are calculated for the applicable shareholder class taken as a whole. The ratio for an individual investor may vary from these ratios based on different management fee arrangements and the timing of subscriptions and redemptions.